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IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,
Petitioner

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE,
Respondent

On Writ of Certiorari to the Tennessee Supreme Court

BRIEF OF THE INSTITUTE OF INTERNATIONAL CONTAINER LESSORS, CRONOS CONTAINERS, FLEXI-VAN LEASING, INC., GENSTAR CONTAINER CORP., TEXTAINER EQUIPMENT MANAGEMENT (U.S.) LTD., TRANS OCEAN LTD., TRANSAMERICA LEASING INC., TRITON CONTAINER INTERNATIONAL LTD., SEA CONTAINERS LTD., CLOU CONTAINER LEASING GMBH, AND MATSON LEASING COMPANY AS AMICI CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

The question amici will address corresponds to Question 1 in the petition for a writ of certiorari:

> Whether the Foreign Commerce Clause precludes the imposition of a state sales tax on the entire lease proceeds of containers that are only briefly present in the State during the course of international transit?

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INTEREST OF THE AMICI CURIAE

With the consent of the parties pursuant to Rule 37 of the Rules of this Court, the amici curiae submit this brief in support of petitioner.

The amici curiae are firms primarily engaged in the business of leasing marine cargo containers to international shipping lines for use in the worldwide transportation of goods. Together, the amici represent more than 95 percent of the United States container leasing industry. Six of the amici are incorporated in the United States, two in Bermuda, one in the United Kingdom, and one in Germany. Seven belong to the Institute of International Container Lessors, the trade association for the international container leasing industry.

The decision below threatens to injure the international container leasing industry by shattering the longstanding global understanding that containers are not subject to sales, use or similar transaction taxes. It also permits a tax on the entire rental proceeds of a container lease even though the container is only temporarily located in a State during the course of its international journey. Other States will inevitably follow Tennessee's lead and adopt the politically attractive and lucrative means of taxing the lease proceeds of containers passing through their territories. Similarly, foreign nations will be induced to apply their own taxes to containers flowing through their borders. The end result will be to subject container leases to wholly disproportionate and duplicative taxes. Such taxes will substantially impair the international transport of goods by eviscerating the economic advantages associated with container leasing.

Because amici would be critically affected by a decision allowing States to impose sales, use or similar transaction taxes on the lease of marine cargo containers, their view on the constitutionality of such taxes may be of substantial assistance to the Court's consideration of this case.

STATEMENT

The particular facts of this case are stated in the petitioner's brief and are not repeated here. Instead, this section gives an overview of those aspects of the international container leasing industry necessary to resolve the issues in this case.

I. THE NATURE AND OPERATION OF THE INTERNATIONAL CONTAINER LEASING INDUSTRY

"One of the most important technological developments in the transportation of goods by sea since steam replaced sail is the advent of the 'container revolution.'" Simon, *The Law of Shipping Containers*, 5 J. Mar. L. Com. 507, 507 (1974). Containers are specially manufactured boxes, usually made of steel, typically 20 or 40 feet long, 8 feet wide, and 8.5 or 9.5 feet tall, that are used to transport goods by ship. Containers are not merely packages to contain goods, but are "permanent, reusable article[s] of transportation equipment." *Id.* at 513. Although containers are intermodal, that is, they can travel equally well by ship, behind a tractor over the road, or on a railroad flat car, they are principally considered to be marine instruments, since virtually every trip made by the typical container involves a sea voyage.

Although containers were first used by shipping lines in the 1950s, the leasing of containers became an important activity during the 1960s. See *Trends in International Taxation* 18 (Organization for Economic Cooperation and Development 1985). The international leasing industry greatly facilitates, and reduces the cost of, the international transport of goods by providing a pooling mechanism that efficiently manages the distribution of containers to shipping lines. Thus, the container leasing industry performs "an important service for the world transportation system." *Ibid.*

Today, containers are the principal means for marine transportation of manufactured products and also play a significant role in ocean transport of raw materials and agricultural products. The current world fleet of containers is approximately 6.7 million TEU.[1] Almost half of

[1] TEU stands for twenty-foot equivalent units. One twenty-foot container equals one TEU; one forty-foot container equals two TEU.

that fleet is owned by leasing companies, with international shipping lines owning the other half. U.S. domiciled companies—including shipping lines and leasing companies—own approximately 37 percent of all containers. See *Cargoware International*, Dec. 1990, at 7. The U.S. container leasing industry—which is the largest in the world—accounts for over 25 percent of the world's containers. *Ibid.* More than 85 percent of the revenues of the U.S. container leasing industry is derived from rentals to shipping lines domiciled in foreign countries.

There are several different types of container leasing arrangements, including short-term (generally six months or less), long-term (generally one to five years), and master lease agreements. Master lease agreements provide lessees with the opportunity to pick up containers at certain ports throughout the world and to drop off containers at other designated ports. In addition, they set the general contract terms and conditions that will apply to all future leases during the agreement period. When containers are picked up under a master lease agreement, there is usually no set period for their return.

Whatever the type of lease, the lessee determines the containers' route of travel, the maximum length of the lease, and at which drop off point the container will be delivered at the close of the lease term. While leases last on average at least a year, they often last as long as five years. Leases usually impose a rental charge on a per diem, or daily rate basis, but are typically billed on a monthly basis. Because lease terms are frequently open-ended and are often renewed, the length, and therefore the entire proceeds, of a lease cannot usually be determined until the ultimate return of a container.

The leasing industry (and thus the international shipment of goods) is facilitated by a worldwide system of depots at which international shipping lines pick up, re-

turn, and reposition containers.[2] Today, there are approximately 500 depots around the world in more than 40 countries. *Containerization International Yearbook* 528-542 (1992). In the United States, there are more than 100 depots in more than 20 States. Although a very few depots are owned and operated by leasing companies, the vast majority are owned and operated by independent enterprises, which serve numerous container leasing companies, as well as other ventures, including shipping lines and truckers. They are usually run by local businessmen who pay property, income and other applicable taxes in operating their businesses.[3]

Containers are in the stream of international commerce for the entire period of their lease. They "engage in no intrastate or interstate transportation of cargo except as continuations of international voyages. * * * Any movements or periods of nonmovement of containers * * * are essential to, and inseparable from, the containers' efficient use as instrumentalities of foreign commerce." *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434, 437 (1979). As virtually all containers are manufactured abroad—largely in the Far East—containers typically begin their journey in a foreign country. Thus, they usually enter the United States transporting goods from other countries.

In the United States, leases generally begin when a shipping line needs a container to export goods overseas. After sending a trucker to pick up an empty container at

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[2] Occasionally, the leasing companies will reposition the containers themselves when particular depots build up surpluses or shortages.

[3] Neither the lessor nor the lessee of a container is usually domiciled, or even has a marketing office, in the State in which the container is picked up pursuant to a lease. Nor is the lease typically solicited, negotiated or executed in such a State. Indeed, leasing companies typically maintain only a handful of marketing offices in the United States.

a depot, the lessee will transfer it immediately to a manufacturer to be loaded with goods, and then to a port for travel overseas. Often the manufacturer is located out of state; in that case, the container will stay in the depot state for no more than a day after being picked up by the lessee. If the manufacturer is located in the depot state, the container will usually remain in the State for less than a week before being transferred to the port. While a container delivered pursuant to a lease in the United States will initially be used to export American goods to foreign ports, it will subsequently be used in myriad other import-export shipments, spending the majority of its time overseas.

II. THE REGULATION OF CONTAINERS AS INSTRUMENTALITIES OF FOREIGN COMMERCE

Because of their status as instrumentalities of foreign commerce, containers are subject to a series of international treaties, federal laws, and regulations. The most relevant treaties are the 1972 Customs Convention on Containers, 988 U.N.T.S. 43, and the 1956 Customs Convention on Containers, 20 U.S.T. 301, which seek to facilitate the international shipment of goods by exempting containers from customs duties and other taxation.[4] The 1972 Convention requires all signatory nations, including the United States, to grant "temporary admission to containers, whether loaded with goods or not." Art. 3, 988 U.N.T.S. at 45. "Temporary admission" is defined to mean "temporary importation, subject to reexportation, free of import duties and taxes and free of import prohibitions and restrictions." Art. 1(b), *id.* at 44. The term "import duties and taxes" is broadly defined to "mean Customs duties and *all other* duties, taxes, fees and other charges which are collected on or in connexion with, the importation of goods." Art. 1(a), *id.* at 44 (emphasis supplied). The Convention requires strict compliance with a number of regulations, including a restriction on the use of the containers in domestic traffic (art. 9, *id.* at 46; annex 3, *id.* at 52), and a general requirement of reexportation within three months from the date of importation (art. 4, *id.* at 45), to qualify for these benefits.[5]

[4] In addition to the Customs Conventions, the United States has entered into the International Convention for Safe Containers, 29 U.S.T. 3707, 1064 U.N.T.S. 3, which establishes safety standards for containers.

Pursuant to the 1972 Convention and its predecessor, the 1956 Convention, the United States has promulgated a number of regulations governing containers. Upon their arrival in the United States, containers are registered with the Customs Service as "instruments of international traffic" that are exempt from the customs laws, including the payment of customs duty so long as they are used solely in international commerce. 19 C.F.R. §§ 10.41a(a)(1), (3) and § 10.41a(f) (1991). Upon entry of containers into the United States, their owners must post a continuous bond with the Customs Service to cover all duties, taxes or liquidated damages that could be assessed in the event of a container's unlawful use in intrastate or interstate commerce. 19 C.F.R. § 10.4a(c) (1991). Once a container becomes unsuitable for use, the owner is required to file notification with the Customs Service in order to remove it as an instrument of international traffic. See 19 C.F.R. 10.41(e) (1991). The company then typically resells the container for scrap or domestic use.[6]

[5] Because of the limited space granted amici, this brief does not specifically address the 1956 Convention. But the same arguments made with respect to the 1972 Convention apply with equal force to the 1956 Convention.

[6] A tiny fraction of containers has been "domesticated" for use in interstate commerce. Containers are not generally used for domestic commerce simply because it is less expensive to ship goods by ordinary tractor/trailer truck than by container, if a trip does not involve a sea voyage.

III. THE APPLICATION OF TENNESSEE'S SALES TAX TO CONTAINERS USED EXCLUSIVELY IN FOREIGN COMMERCE

The tax at issue in this case was imposed under the Tennessee Retailer's Sales Tax Act, which imposes a 5.5 percent tax on tangible personal property sold in the State. Two provisions of the Act are applicable to container leases. First, the Act declares that "every person is exercising a taxable privilege who engages in the business of selling tangible personal property at retail in this state * * * or who rents or furnishes any of the things or services taxable under this chapter [or who] leases or rents property, either as lessor or lessee, within the state of Tennessee." Tenn. Code Ann. § 67-6-201 (1989). Second, Tennessee includes the term "lease or rental" within the statutory definition of the term "sale." Specifically, it defines a "sale" as "any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration." *Id.* § 67-6-102(23)(A).

The Supreme Court of Tennessee found that the foregoing provisions apply to leases of containers delivered in Tennessee because they manifest "the legislature's intent to tax the transfer of possession of tangible personal property in Tennessee, pursuant to lease agreements executed outside of Tennessee." *Itel Containers Int'l Corp.* v. *Cardwell*, 814 S.W.2d 29, 31 (1991). Because Tennessee's sales tax is triggered by the mere transfer of possession in Tennessee, the Court found that it applies to container leases despite the fact that "[t]he interruption of movement in Tennessee [i]s not for the purpose of any use of the Containers prior to the continuation of international movement." Statement of Stipulated Facts ¶ 78.

The measure of Tennessee's sales tax on the lease of containers delivered in its jurisdiction is the gross proceeds of the lease over its entire term. See Tenn. Comp. R. & Regs. tit. 18, ch. 1320-5-1.32(1) (1991). A container lessor is required to pay the tax "on a billing basis, either on the lump sum at the time of execution, or on a monthly or periodical basis as provided in the contract." *Id.* ch. 1320-5-1.32(2). Thus, because container leases are generally billed on a monthly basis, lessors that deliver containers in Tennessee will be required to submit a tax to the State each month for as long as the lease continues. While the legal incidence of the tax falls on the container lessor, state law provides that the tax must be separately stated on the bill submitted to the lessee and "shall be collected by the retailer from the consumer insofar as it can be done." Tenn. Code Ann. § 67-6-502 (1989). Lessors must continue to collect such taxes from lessees even though the container leaves Tennessee and never enters the State again.[7] Accordingly, if a lessee picks up a container in Tennessee and then uses it for the next three years to transport goods solely between Yokahama and Sacramento, each monthly payment on the lease for those three years will be subject to Tennessee's sales tax even though the container never again enters Tennessee.

The imposition of Tennessee's sales tax on the gross proceeds of container leases appears to be the first application of its kind. Amici are aware of no other State or foreign nation that has attempted to apply a sales, use or similar transaction tax to containers used solely in international commerce.

SUMMARY OF ARGUMENT

The imposition of a sales or similar transaction tax on the gross proceeds of container leases violates three specific provisions of the Constitution, namely, the Commerce

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[7] See Tenn. Comp. R. & Regs. tit. 18 ch. 1320-5-1.32(2) (1991) ("The Sales Tax shall apply to all leases of tangible personal property delivered to a lessee or rentee in this State, regardless of where the property will be taken or used by the lessee or rentee, whether within or without the State of Tennessee.").

Clause (Art. I, § 8, Cl. 3), the Supremacy Clause (Art. VI, Cl. 2) and the Import-Export Clause (Art. I, § 10, Cl. 2). Given the substantial overlap of the arguments under these three Clauses, as well as the limited space allotted to amici, this brief specifically addresses only the Commerce Clause violation. Amici fully agree, however, with the arguments presented in petitioner's brief pertaining to the other two constitutional violations.

To begin with, Tennessee's tax flagrantly violates the Commerce Clause test articulated by this Court in *Japan Line* by creating a substantial risk of international multiple taxation—one of the primary evils the Commerce Clause was designed to prevent. 441 U.S. at 451. Because containers travel through numerous foreign countries, other jurisdictions have equal opportunity to tax the same container lease proceeds taxed by Tennessee. To date, they have adhered to the long-established understanding that container leases should be free from taxation. If the Tennessee tax is upheld, however, these jurisdictions will surely respond with duplicative taxes. Given the absence of any central international body able to prevent such double taxation, neither Tennessee—nor any other State—can be permitted to impose a tax on the lease of containers used exclusively in international commerce.

Tennessee's tax also runs afoul of the Commerce Clause by preventing the federal government from "speaking with one voice" in the area of foreign relations. *Ibid.* Under the ruling below, each State would be able to interfere with one of the cornerstones of international relations: the free passage of instrumentalities of foreign commerce through the borders of the international community of nations. This interference would place the United States in direct violation of its treaty obligations under the Customs Convention on Containers, and would inevitably lead to foreign retaliatory measures against not only Tennessee, but the nation as a whole. That the risk of retaliation is a real one is demonstrated by the

recent formal objection to Tennessee's tax lodged with the U.S. Department of State by eleven foreign countries. Reversal of the decision below is therefore necessary to ensure that individual States and localities will not become hopelessly and dangerously enmeshed in international trade and taxing disputes to the detriment of the entire country.

Finally, Tennessee's tax transgresses the Commerce Clause because it is not fairly related to the services provided by the State and because Tennessee lacks a sufficient nexus to tax containers merely delivered in its jurisdiction. *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977). These conclusions follow from the fact that Tennessee's tax applies to the entire proceeds of container leases notwithstanding that (1) containers spend the vast majority of the lease terms outside of Tennessee; (2) lessors typically have no contact with the State beyond the mere delivery of containers in its borders; and (3) transfers are "not for the purpose of any use of the Containers prior to the continuation of international movement" (Statement of Stipulated Facts ¶ 78). While Tennessee may be permitted to apply its sales tax to leased property used in domestic commerce, the special qualities of containers plainly preclude it from taxing the entire lease proceeds of containers used exclusively in foreign commerce.

ARGUMENT

I. A STATE TAX ON THE ENTIRE LEASE PROCEEDS OF CONTAINERS USED EXCLUSIVELY IN FOREIGN COMMERCE VIOLATES THE COMMERCE CLAUSE

Because containers are "instrumentalities of foreign commerce," Tennessee's tax must satisfy both the *Japan Line* and *Complete Auto* tests in order to pass muster under the Commerce Clause. *Japan Line*, 441 U.S. at 437, 451. In this regard, it is important to note that the

tests are not mutually exclusive; they overlap to a greater or lesser extent, depending on the facts and circumstances of the particular case. To withstand constitutional scrutiny under these tests, a state tax must not "create[] a substantial risk of international multiple taxation" or "prevent[] the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Ibid.* (citation omitted). In addition, it must be fairly related to the services provided by the State and applied to an activity that has a substantial nexus with the taxing State. *Complete Auto*, 430 U.S. at 279. If a state law violates any of these precepts, it is unconstitutional under the Commerce Clause.

In light of the unique nature of containers as instrumentalities of international traffic, Tennessee's attempt to apply its sales tax to the gross proceeds of container leases directly contravenes the principles articulated in *Complete Auto* and *Japan Line*.[8]

A. Tennessee's Tax Creates A Substantial Risk Of International Multiple Taxation

First and foremost, the application of Tennessee's sales tax to the gross proceeds of container leases violates the Commerce Clause by "creat[ing] a substantial risk of international multiple taxation." *Japan Line*, 441 U.S. at 451. This risk stems from the fact that containers are instrumentalities of foreign commerce that spend the majority of their rental periods overseas, travelling

[8] Although petitioner has not focused on the specific prongs of the *Complete Auto* test, those prongs are clearly encompassed in the question presented in this case, namely, whether the application of Tennessee's sales tax to container leases violates the Foreign Commerce Clause. As this Court held in *Japan Line*, to survive scrutiny under the Foreign Commerce Clause, a state tax must pass the tests set forth in *both Japan Line* and *Complete Auto*. See 441 U.S. at 451. This holding makes perfect sense, given the substantial overlap of the principles animating both tests.

through dozens of foreign countries. These foreign jurisdictions have an equal right to tax the rental proceeds of containers flowing through, and stopping briefly within, their borders. For example, if Japan and France were to impose a use tax on the rent paid for containers used in their territory, the rent paid for a container delivered in Tennessee, but travelling solely between Yokahoma, Le Havre and Sacramento during its lease, would be subject to duplicative taxation by Tennessee, France and Japan (not to mention the potential for additional taxation by California).

The Supreme Court of Tennessee sought to avoid the conclusion that Tennessee's tax creates a risk of multiple taxation by reasoning that "the transfer of possession of cargo containers in Tennessee is a discrete transaction, occurring only within Tennessee." *Itel Containers*, 814 S.W.2d at 36. This reasoning, however, is fatally flawed. Contrary to the Tennessee court's suggestion, Tennessee's tax is not a tax on the delivery or transfer of goods within its borders, but a tax on the proceeds of leases. Indeed, even if it were specifically labeled a tax on delivery or transfer under a lease, it would still be a tax on the gross proceeds of leases because that is the measure of the tax. As this Court recently noted, "[a] tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes." *Trinova Corp.* v. *Michigan Dept. of Treasury*, 111 S. Ct. 818, 829 (1991) (quotation and citation omitted).

This Court has consistently rejected attempts such as Tennessee's to sustain a tax by characterizing a transaction as occurring only within a single State. In *Central Greyhound Lines, Inc.* v. *Mealy*, 334 U.S. 653 (1948), for example, New York sought to impose a gross receipts tax on interstate motor bus transportation that originated in and terminated in the State. In striking down the tax, the Court properly held that "[t]o say that this commerce is confined to New York is to indulge in pure fiction. To do so, does not eliminate the relation of

[other States] to the transactions nor eliminate the benefits which those * * * States confer upon the portions of the transportation within their borders. Neither their interests nor their responsibilities are evaporated by the verbal device of attributing the entire transportation to New York." *Id.* at 660.

Similarly, in *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U.S. 157 (1954), this Court struck down a tax on the delivery within Texas of natural gas to a pipeline, measured by the entire volume of gas to be shipped in interstate commerce, because "[t]his economic process is inherently unsusceptible of division into a distinct local activity capable of forming the basis for the tax here imposed." *Id.* at 167. Likewise, the court's ruling below that the entire lease of a container occurs in Tennessee simply because delivery occurs there is nothing more than pure fiction. By ignoring the relationship that other jurisdictions have to container leases, the court utterly failed to comprehend the real risks of multiple taxation posed by Tennessee's tax.[9]

Specifically, the risk of multiple taxation of container leases is created by the flow of containers through many domestic and foreign taxing jurisdictions that both can and do tax the proceeds of various kinds of leases under theories flatly inconsistent with the fiction that the lease is a "discrete transaction" that "occurs" only in the place of delivery. California, for example, views leases as "continuing purchases" and imposes its use tax upon leased

[9] In finding that Tennessee's tax on container leases falls on a discrete local incident occurring only within Tennessee, the court below relied heavily on *Wardair Canada, Inc.* v. *Florida Dept. of Revenue*, 477 U.S. 1 (1986). In that case the Court held that a sales tax on jet fuel sold to international carriers failed to create a risk of multiple international taxation because the tax was "imposed only upon * * * a discrete transaction which occurs within one national jurisdiction only." *Id.* at 9. But in contrast to a container lease, which occurs in numerous foreign jurisdictions, the sale of aviation fuel is incapable of being taxed by foreign jurisdictions, given that it is typically consumed en route from the United States.

property according to the time spent by the property in the State. Cal. Code Regs. tit. 18, § 1660(b)(2) (1991). Moreover, California does not give a credit for sales or other taxes paid to other States on the same rents subject to its use tax. Cal. Code Regs. tit. 18, § 1660(c)(8) (1991). Thus, if California were to apply its use tax to containers, the same rental payments on containers delivered in Tennessee would be taxed by both California and Tennessee.[10]

Similarly, foreign nations and their various subnational units have the capacity to collect the equivalent of state sales and use taxes upon containers used within their territories. The members of the European Community, for example, impose value added taxes on the rent paid for the use of property within their jurisdiction. See Council Directive 77/388, Arts. 2, 6, & 9, 1977 O.J. (L. 145) 1, 3-5. Similarly, British Columbia generally imposes a use tax on leased property brought into its jurisdiction. See R.S.B.C., c. 388, § 2.1 (1991). The imposition of EC and British Columbia value added and use taxes on container leases would clearly inflict a multiple burden by taxing the same rental payments taxed by Tennessee.

[10] Indeed, most States impose a use tax on rentals of leased property used within their borders. See, *e.g.*, Georgia (Ga. Code Ann. § 48-8-30(3) (Michie 1991)); Illinois (Ill. Rev. Stat. ch. 120, para. 439.2 (1989)); New Jersey (N.J. Stat. Ann. §§ 54:32B-2(e) & (f) and 54:32B-6 (West 1991); N.J. Div. of Tax Notice to Vendors, July 5, 1989, reprinted in, New Jersey Tax Reports, ¶ 400-001 (CCH 1989)); New York (N.Y. Tax Law §§ 1101(b)(4), 1104 (b)(5), 1110 (McKinney 1992)); and Texas (Tex. Admin. Code tit. 34, § 3-294(f)(1) (1992); Comptroller of Public Accountants, Hearing No. 26,852 (June 20, 1991)). Indeed, Tennessee itself imposes a use tax on leased property delivered elsewhere. See Tenn. Code Ann. § 67-6-201, 67-6-102(4)(f) (1989); *Magnavox Consumer Electronics* v. *King*, 707 S.W.2d 504, 505 (Tenn. 1986). Georgia appears to impose a tax on the mere execution of a lease. See 1969 Op. Georgia Atty. Gen., No. 69-146.

Because Tennessee's tax is, like Japan's tax in *Japan Line*, imposed on an unapportioned basis, that is, upon the "full value" of the lease, the imposition of *any* foreign tax on container lease proceeds, even an apportioned one, would "inevitably" result in multiple taxation. *Japan Line*, 441 U.S. at 447. But even if Tennessee were to apportion its tax, container leases would still be subjected to duplicative taxation as soon as any one of dozens of countries through which containers move taxed an unapportioned share of the rental proceeds. "Even a slight overlapping of tax—a problem that might be deemed *de minimus* in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." *Japan Line*, 441 U.S. at 456. Here, because most foreign countries do not provide for credits for taxes paid to other countries, the risk that Tennessee's tax will result in substantial multiple taxation is extremely high.[11]

The risk that other foreign nations might impose multiple taxation on container leases requires invalidation of Tennessee's attempt to apply its sales tax to such leases. As this Court recognized in *Japan Line*, in the international arena there is no "authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value." *Japan Line*, 441 U.S. at 447. Thus, Tennessee cannot be permitted to impose even an apportioned tax on container rentals—much less the unapportioned tax that is at issue in this case. If taxes are

[11] The chaos that would result from upholding Tennessee's tax is aptly illustrated by the following example. If the various foreign nations withdrew their tax exemptions for container leases, the rent paid for a container delivered in Tennessee and used to transport goods from there to Vancouver, British Columbia, and then to Oakland, California, and finally to Paris, France, would be subject to taxation by British Columbia, California and France, as well as by Tennessee. If the Court allows Tennessee to apply its sales tax to container leases, the Court could prevent California from imposing a sales or use tax on the rents taxed by Tennessee but could do nothing to prevent British Columbia or France from taxing them.

to be imposed on container rentals, they must be imposed through the federal government, which, unlike Tennessee, is capable, through the use of the treaty power, of protecting against duplicative taxation of containers.

That no actual multiple international taxation has occurred as of yet is entirely inconsequential. The absence of such taxation is due solely to the common understanding in the international community that containers should be free from sales or similar taxes.[12] Moreover, as this Court has held, the fact "that, for the time being, only one State has taxed is irrelevant to the kind of freedom of trade which the Commerce Clause generated. The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment." *Freeman* v. *Hewit*, 329 U.S. 249, 256 (1946).[13] This reasoning applies with even

[12] The members of the European Community, for example, have exempted container leases from value added taxation by treating them as within a ruling precluding taxes on the temporary import of goods. See Council Directive 77¶388, Arts. 14(1)(c), 15(1), 1977 O.J. (L. 145) 1. Similarly, the Japan Consumption tax exempts container rents from its scope where the containers are used in international commerce. See Consumption Tax Law, Art. 7(1)(v); Consumption Tax Enforcement Order, Art. 17(2)(ii). British Columbia has informally exempted containers from its use tax on leased property on the basis of an exemption relating to vessels. See R.S.B.C. c. 388 § 4(1)(k) (1991).

[13] See also *Mobil Oil Corp.* v. *Commission of Taxes of Vermont*, 445 U.S. 425, 443 (1980) ("the constitutionality of a [state] tax should not depend on the vagaries of [another State's] tax policy"); *Armco Inc.* v. *Hardesty*, 467 U.S. 638, 644-645 (1986) (the constitutionality of a State's tax laws should not "depend on the shifting complexities of the tax code of 49 other states"); I J. Hellerstein, *State Taxation* ¶ 4.6[1][b], at 119 (1983) (the "actual multiple taxation rule is an unwise and unacceptable method of delineating the State taxing powers under the Commerce Clause" because the constitutionality of a State's statutes ought "not depend upon the present configuration of the statutes of another State") (quoting *General Motors Corp.* v. *Washington*, 377 U.S. 436, 458 (1964)).

greater force in the international sphere. The constitutionality of a state tax should not be made to depend on the present configuration of the various tax codes adopted by the international community of nations.[14]

Thus, because the same rental proceeds from containers subject to tax by Tennessee may be taxed by other foreign countries, Tennessee's tax poses "the risk of a double tax burden * * * which the commerce clause forbids." *J.D. Adams Mfg. Co.* v. *Storen*, 304 U.S. 307, 311 (1938).

B. A State Tax On Container Leases Prevents The Federal Government From Speaking With "One Voice" In The Area Of Foreign Relations

As this Court recognized in *Japan Line*, the Commerce Clause commits to the exclusive authority of the federal government the regulation of those aspects of foreign commerce that by their very nature "necessitate a uniform national rule." 441 U.S. at 449. Pursuant to this rule, a tax will be held invalid if it "prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Id.* at 451. A state tax "will violate the 'one voice' standard if it either implicates foreign policy issues which must be left to the Federal Government or violates a clear federal directive." *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159, 194 (1983). This latter test is essentially "a species of preemption analysis." *Ibid.* Like the California property tax imposed on containers in *Japan Line*, Tennessee's tax violates both prongs of the "one voice" test.

1. *Tennessee's Tax Violates A Clear Federal Directive*

The plain language of the 1972 Container Convention, as well as the comprehensive network of treaties,

[14] A rule requiring a showing of actual multiple taxation would produce the anomalous result of forcing taxing jurisdictions and taxpayers to go back to court each time a foreign nation passed or repealed a conflicting tax.

statutes, and regulations governing containers, reveal a "clear federal directive" against the application of state sales taxes such as Tennessee's to containers used solely in international commerce. Tennessee's tax specifically contravenes the 1972 Container Convention requirement that signatory nations admit containers "free of import duties and taxes and free of import prohibitions and restrictions." Arts. 1(b), 3, 988 U.N.T.S. 43, 44-45. The term "import duties and taxes" is expansively defined to "mean Customs duties *and all other* duties, *taxes*, fees and other charges which are collected on, or *in connexion with*, the importation of goods." Art. 1(a), 988 U.N.T.S. 44 (emphasis added). Because a tax on the transfer of containers temporarily admitted to the United States as part of a continuous process of importation and exportation is one "in connection with" the import of containers, such a tax directly violates the Convention.[15] This interpretation is strongly supported by the failure of any party to the Convention to impose a sales or similar tax on containers used in international traffic. See *O'Connor* v. *United States*, 479 U.S. 27, 33 (1986); *Trans World Airlines, Inc.* v. *Franklin Mint Corp.*, 466 U.S. 243, 262 (1984).

In addition to contravening the Convention's plain terms, state taxation of container leases conflicts with the express and fundamental purpose of the treaty: "to develop and facilitate international carriage by container." 988 U.N.T.S. 43, 44. Tennessee's tax contravenes this purpose by imposing not only a severe financial burden on container transportation, but a serious administrative burden. If Tennessee's tax is sustained, other States and countries will inevitably respond with taxes of their own on container leases. This multiplicity of tax regimes, each with its own set of detailed regulations, would create

[15] A tax on container leases is also "in connection with" imports insofar as it interferes with the international system of container transportation, thereby impeding the ability of shipping lines to import goods by container.

a bureaucratic nightmare for international container leasing companies and shipping lines in operating their businesses around the world.

Significantly, the blatant inconsistency between state taxation of containers and the goals of the Container Convention was a central aspect of the Court's reasoning in striking down California's property tax on containers in *Japan Line*. In invalidating the tax, the Court explained that "[t]he desirability of uniform treatment of containers used exclusively in foreign commerce is evidenced by the Customs Convention on Containers. * * * The Convention reflects a national policy to remove impediments to the use of containers as 'instruments of international traffic.'" *Japan Line*, 441 U.S. at 452-453 (quoting 19 U.S.C. § 1322(a)). See also *Xerox Corp.* v. *Harris County*, 459 U.S. 145, 151 (1982) (invalidating state taxation of goods stored under bond in Customs bonded warehouses because such taxation conflicted with the policy behind the federal warehouse statutes of "encourag[ing] merchants here and abroad to make use of American ports").

Indeed, the United States itself has recognized the preemptive effect of the Customs Convention on state taxation of containers. What the federal government said with respect to the California tax in its amicus brief in *Japan Line* applies with equal force to the Tennessee tax: it "lessens the effectiveness of the Customs Convention on Containers in aiding foreign commerce and interferes with the comprehensive scheme of federal regulation of instrumentalities of foreign commerce. The state tax thus constitutes an obstacle to the realization of the foreign policy of the United States. It intrudes, as the voice of one of 50 states, into an area where the United States has spoken and should continue to speak with one voice." U.S. Br. as Amicus Curiae, No. 77-1378, at 7-8.

2. *Tennessee's Tax Implicates Foreign Policy Issues That Must Be Left To The Federal Government*

In addition to violating a clear federal directive, state taxation of container leases is invalid because it "implicate[s] foreign policy issues which must be left to the Federal Government." *Container Corp.*, 463 U.S. at 194. To begin with, such taxes would substantially disrupt the ability of the federal government to conduct trade with its foreign trading partners. The federal government's efforts in the international sphere reveal an overarching and coherent policy of reciprocal tax exemptions governing the international container industry. As already indicated, the nation's container relations with foreign governments are implemented through a comprehensive network of treaties and federal statutes and regulations. Pursuant to this network, our trading partners have all refrained from subjecting container leases to sales, use or similar transaction taxes. A decision upholding Tennessee's tax would therefore not only place the federal government in violation of its current treaty obligations, but would substantially diminish its credibility in negotiating future reciprocal agreements with foreign governments.[16]

Perhaps the most dangerous foreign policy implication of Tennessee's tax is the likelihood that it will prompt foreign retaliation against the United States. See *Japan Line*, 441 U.S. at 450. The only reason our foreign trading partners have refrained from imposing sales or similar taxes on containers owned by American companies is the reciprocal international policy of tax exemption. But if the Tennessee tax is upheld, there will exist a

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[16] Moreover, "[i]f other States follow [Tennessee's] example * * * containers will be subject to various degrees of multiple taxation, depending on which American [States] they enter. This result, obviously would make 'speaking with one voice' impossible." *Japan Line*, 441 U.S. at 453.

breach in the international understanding that containers are free from taxation. Because Tennessee may not constitutionally apply its sales tax in a discriminatory manner, that is, to American, but not foreign, leasing companies,[17] there is no question that this breach will spark retaliatory action against the United States by foreign countries whose container leasing companies will be subject to the Tennessee tax. Retaliation may take the form of either general trade sanctions against the United States, or taxes on American container leasing companies whose containers are used in foreign jurisdictions.

Tennessee's tax is also certain to prompt foreign retaliation as a result of its burden on foreign shipping lines, which will be forced to bear an estimated 85 percent of Tennessee's tax. There is no doubt that American leasing companies will follow the mandates of Tennessee law and pass the tax on to their customers—the bulk of which are foreign shipping lines.[18] Thus, even if this Court were to allow Tennessee to apply its tax solely to American leasing companies, foreign retaliation against the United States would still be likely to result from the financial hardship imposed upon foreign shipping lines by Tennessee's tax.

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[17] As Justice Powell concluded, writing for the three members of the *Container Corp.* Court who reached the question, just as a State cannot discriminate against out-of-state residents in favor of its own citizens, it cannot discriminate against a corporation domiciled in another State and "in favor of an overseas corporation" unless it receives "explicit congressional authorization." 463 U.S. at 203 (Powell, J., dissenting).

[18] As noted earlier, while the legal incidence of the Tennessee tax falls on the container lessor, the law provides that it shall be collected from the lessee. Tenn. Code Ann. 67-6-502 (1989). This obligation to collect the tax from the lessee is mandatory. See *Hooten* v. *Carson*, 209 S.W.2d 273, 275 (Tenn. 1948). Indeed, a seller or lessor who fails to collect the tax may subsequently bring an action against the purchaser or lessee for the amount due or paid. See *Sam Carey Lumber Co.* v. *Sixty-One Cabinet Shop, Inc.*, 773 S.W.2d 252, 254-55 (Tenn. App. 1989).

Just as in *Japan Line*, the risk of foreign retaliation is "acute" in this case. 441 U.S. at 453. Eleven countries—the United Kingdom, Germany, France, Italy, Denmark, Finland, Japan, the Netherlands, Norway, Spain, and Sweden—have already lodged a formal complaint regarding Tennessee's tax with the U.S. Department of State. See Diplomatic Note (filed April 28, 1992). These countries charge that a tax on container leases such as Tennessee's is in "direct contravention" of the Customs Convention and "pose[s] an unjustified and unacceptable burden on international shipping companies and their customers." *Ibid.* Given their view of the tax as "unjustified and unacceptable," there can be no doubt that if the Tennessee tax is allowed to stand, these foreign nations will take retaliatory measures that will be felt not only by Tennessee, but "by the Nation as a whole." 441 U.S. at 453.

In addition to the significant threat of foreign retaliation, state taxes on container leases have a number of other foreign commerce implications that demonstrate the need for uniform federal treatment in this area. Specifically, by increasing the cost of the international transport of goods by container, such taxes would raise the trading barriers between America and its foreign trading partners and increase the cost of U.S. exports, thereby discouraging the consumption of American goods overseas.

Furthermore, such taxes would have the perverse effect of inducing international shipping lines—which are not generally subject to sales or similar transaction taxes on containers bought abroad—to buy, rather than lease, containers. This would not only financially devastate the international container leasing industry, but would thwart its salutary function of providing a pooling system that effectively responds to the shifting imbalances in container demand. As a result, the efficient international shipment of goods would be substantially impaired.[19]

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[19] Moreover, if this Court were to allow (or require) States to apply their taxes only to American-owned containers, U.S. con-

While such undesirable effects do not in and of themselves condemn a tax under the Commerce Clause, they demonstrate the serious foreign commerce ramifications of upholding the decision below. They are also wholly at odds with the federal policy, as expressed in the Container Convention and its implementing regulations, of facilitating the international transport of goods by container. Neither Tennessee—nor any other State—can, "by its unilateral act, * * * be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." *Japan Line*, 441 U.S. at 453.

C. Application Of Tennessee's Sales Tax To The Entire Proceeds Of A Container Lease Is Neither Fairly Related To The Services Provided By The State Nor Supported By A Sufficient Nexus

Tennessee's tax also infringes the Commerce Clause because it is not fairly related to the services provided by Tennessee and because Tennessee lacks a sufficient nexus to tax container leases. See *Complete Auto*, 430 U.S. at 279. Both of these conclusions ineluctably follow from the special characteristics of containers as instrumentalities used exclusively in foreign commerce.

Under the test enunciated by this Court in *Complete Auto*, a tax must be "fairly related to the services provided by the state" in order to pass muster under the Commerce Clause. *Ibid.* A State may exert its taxing power only "in relation to opportunities which it has given, to protection which it has afforded, [and] to benefits which it has conferred by the fact of being an orderly civilized society." *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 625 (1981) (citation omitted).

tainer leasing companies would be at a significant competitive disadvantage versus foreign container leasing companies. Instead of leasing containers from American companies subject to such taxes, international shipping lines would simply lease them from foreign leasing companies. This would deal a severe—if not fatal—blow to the U.S. container leasing industry.

"[W]hen the measure of a tax bears no relationship to the taxpayers' presence or activities in a State, a court may properly conclude under the fourth prong of the *Complete Auto Transit* test that the State is imposing an undue burden on interstate commerce." *American Trucking Ass'ns, Inc.* v. *Scheiner*, 483 U.S. 266, 291 (1987) (quotation omitted).

Tennessee's effort to apply its sales tax to the gross rental proceeds of containers delivered in its borders directly conflicts with these principles. Indeed, Tennessee's tax is more than "unfairly related"; it is grossly disproportionate to the benefits provided to container lessors and lessees. Containers delivered in Tennessee are in the State only for a matter of days before continuing on their international journey. This "interruption of movement in Tennessee [i]s not for the purpose of any use of the Containers prior to the continuation of the international movement." Statement of Stipulated Facts ¶ 78. Yet notwithstanding that containers are only in the State for a brief "interruption," Tennessee still requires lessors to collect, and submit to the State, a tax on each future payment billed under the lease—an obligation that could last for many years. Indeed, because many lease terms are open-ended, lessors could be required to pay a tax to Tennessee indefinitely even though their containers never enter the State again. This gross lack of proportionality between the asserted reach of Tennessee's tax and the benefits provided by the State cannot withstand Commerce Clause scrutiny.[20]

This conclusion is strongly supported by this Court's decisions in *Central Greyhound Lines, Inc.* v. *Mealy*, 334

[20] The total lack of relationship between a tax on the entire proceeds of a container lease and the services provided by Tennessee is clearly illustrated by comparing a container leased for five years with one leased for six months. The former container will be forced to bear a tax burden ten times greater than the latter container bears despite the absence of any difference in the amount of activity or presence in Tennessee.

U.S. 653, 663 (1948), where the Court held that a gross receipts tax on interstate motor bus transportation violated the Commerce Clause because it "makes interstate transportation bear more than 'a fair share of the cost of the local government whose protection it enjoys.'" (citation omitted). Similarly, in *Michigan-Wisconsin Pipeline*, 347 U.S. 157, this Court invalidated a Texas tax on the transfer of natural gas within the State, measured by the entire volume of gas to be shipped in interstate commerce, because it "did not relate to the length of the Texas portion of the pipeline or to the percentage of the taxpayer's business taking place in Texas." *Department of Rev.* v. *Association of Washington Stevedoring Cos.*, 435 U.S. 735, 749 n.18 (1978).[21] If the "fair relationship" prong of *Complete Auto* is to mean anything, a State cannot be allowed to tax the gross rental income of instrumentalities of foreign commerce that have no presence in, or relationship to, the State beyond mere delivery in its borders.[22]

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[21] There is a close analogy between the gas flowing through Texas in *Michigan-Wisconsin Pipeline Co.* and the containers flowing through Tennessee in this case. Like the gas moving through Texas, a container merely passes through a State, "mov[ing] continuously to its outside market" and "ending as contemplated from the beginning beyond the state line." *Michigan-Wisconsin Pipeline Co.*, 347 U.S. at 170. Just as the fact that the gas did not flow immediately out of Texas—it was compressed, cooled, scrubbed and dehydrated at a compressor station owned and operated by the taxpayer (*id.* at 163)—did not allow the State to tax the entire volume of gas, the mere fact of delivery does not allow Tennessee to tax the entire rental payments on containers.

[22] The ephemeral nature of container presence in Tennessee sharply distinguishes this case from *Goldberg* v. *Sweet*, in which the Court found that Illinois' tax on interstate telephone calls was "fairly related to the benefits received by Illinois telephone consumers" because such consumers "subscribe to telephone service in Illinois, own or rent telephone equipment at an Illinois service address, and they receive police and fire protection as well as the other general services provided by the State of Illinois." 488 U.S. 252, 267 (1989).

Because containers merely pass through Tennessee in the midst of their international journey, and are unlikely to enter the State again for the remainder of their lease term, Tennessee also lacks the nexus required to satisfy the Commerce Clause. Neither the lessors nor the lessees of containers typically reside in Tennessee; nor are container leases typically solicited, negotiated, or executed in the State. Indeed, since containers are delivered and picked up by truckers, neither the lessor nor the lessee may ever set foot in Tennessee. In addition, while petitioner happened to own and operate one of the depots to which its containers were delivered in Tennessee for a portion of the lease period, that is atypical. Most depots are owned and operated not by container lessors, but by independent enterprises that pay their own property, income and other applicable taxes to the State.[23]

Moreover, as an analytical matter, containers never even enter Tennessee at all. Containers are admitted in the United States under bond, and subject to reexportation, as "instruments of international traffic." 19 C.F.R. § 10.41a(a)(1) (1991). As such, they are legally treated as never having entered the United States. *Ibid.*[24] It is difficult to see how a container can have *any* nexus with a State—much less one sufficient to support taxation—if it does not even have a legal presence in any of them. See U.S. Br. as Amicus Curiae in *Japan Line*, *supra*, at 30 n.23 (objecting to California's property tax because it was "levied on containers that are still part of foreign commerce and have never been formally entered into United States commerce").

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[23] Thus, if this Court upholds Tennessee's application of its tax in this case, it should at least limit its decision to those taxpayers who own and operate a depot in the taxing State.

[24] Because they do not even enter the commerce of the United States, bonded containers are not properly regarded as "part of the common mass of taxable property within the state." *McGoldrick* v. *Gulf Oil Corp.*, 309 U.S. 414, 429 (1940).

This Court has already indicated that neither the termination of a telephone call nor the delivery of goods by mail or common carrier provides a sufficient nexus for state taxation. See *Goldberg* v. *Sweet*, 488 U.S. 252, 263 (1989); *National Bellas Hess, Inc.* v. *Department of Revenue of Illinois*, 386 U.S. 753, 758 (1967). This conclusion applies with even more force to the mere delivery of containers within a State in light of the "evidence that the Founders intended the scope of the foreign commerce power to be * * * greater" than the interstate commerce power. *Japan Line*, 441 U.S. at 448 (citing historical references).[25] It follows from Congress' greater power over foreign commerce that States require a correspondingly greater nexus to tax such commerce—a nexus that is plainly absent in this case.[26]

* * * *

As Justice Frankfurter has explained, "[t]he task of scrutinizing is a task of drawing lines. This is the historic duty of the Court so long as Congress does not undertake to make specific arrangements between the national government and the States in regard to revenues from interstate [and foreign] commerce. * * * Considerations of proximity and degree are here, as so often in the law, decisive." *Freeman* v. *Hewit*, 329 U.S. 249, 253-254 (1946). The nation's interest in the conduct of its foreign relations and trade outweighs the interest of a State in taxing the entire lease proceeds of an instrumentality of foreign commerce that is subject to a network of U.S. treaties and regulations and that is only temporarily present in the State's borders during the course of international transit. Thus, when the lines are properly drawn in this case, Tennessee's tax must fall.

[25] This Court's cases have "echo[ed] this distinction." *Japan Line*, 441 U.S. at 448 (citing, *inter alia*, *Buttfield* v. *Stranahan*, 192 U.S. 470, 492-493 (1904) (Congress' power over foreign commerce is "exclusive and absolute") and *Bowman* v. *Chicago & N.R. Co.*, 125 U.S. 465, 482 (1888) (laws affecting commerce with foreign nations "are general in their nature, and should proceed exclusively from the legislative authority of the nation")). See also *Wardair Canada, Inc.* v. *Florida Dept. of Revenue*, 477 U.S. 1, 8 (1986) ("allud[ing] to the special need for federal uniformity" in "the unique context of foreign commerce"); *Japan Line*, 441 U.S. at 448 n.13 (while "Congress' power to regulate interstate commerce may be restricted by considerations of federalism and State sovereignty * * *, it has never been suggested that Congress' power to regulate foreign commerce could be so limited").

[26] That containers make their way into the various States does not negate in any way the conclusion that Tennessee's tax is a tax on foreign commerce. As this Court recognized as early as 1824 in the seminal opinion of Chief Justice Marshall in *Gibbons* v. *Ogden*, 22 U.S. (9 Wheat.) 1, 195, foreign commerce "does not stop at the jurisdictional lines of the several States" but proceeds within the states until the movement in commerce is completed." Cf. *Illinois Gas Co.* v. *Public Service Gas*, 314 U.S. 498, 503 504 (1942).

CONCLUSION

The judgment of the Supreme Court of Tennessee should be reversed.

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